

THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Petition of Massachusetts Electric Company)
for review of its electric industry)
restructuring proposal)

D.P.U. 96-25

**INITIAL COMMENTS OF
THE CENTER FOR ENERGY AND ECONOMIC DEVELOPMENT**

The Center for Energy and Economic Development ("CEED") has received and reviewed a copy of the offer of settlement regarding Massachusetts Electric Company's ("MECo") electric industry restructuring proposal ("Settlement") submitted to the Massachusetts Department of Public Utilities ("Department") on October 1, 1996 in the above-referenced proceeding. Pursuant to the Department's Notice of Filing and Public Hearing, forwarded by facsimile to CEED by the Department on October 15, 1996, CEED submits the following initial comments.

INTRODUCTION

Although acknowledging the desirability of settlements in cases such as these, CEED emphasizes the important role that an adjudicatory process plays in ensuring due process is served. This is particularly important in a proceeding such as this one, where the Settlement is still being reviewed for the first time by many prospective parties to this proceeding, and where any approval of this Settlement offer is likely to establish a precedent that could significantly impact the direction and effectiveness of a

restructured electric services industry within the Commonwealth.

CEED acknowledges that there are significant hurdles to be crossed as the industry transitions from one dominated by regulated monopolies to one that relies upon competitive markets. Perhaps the most significant of these is the ability of Massachusetts' utilities to procure a commitment from the Department that they will be provided with a fair and reasonable opportunity to recover those costs associated with resources or regulatory assets that may be rendered above-market or uneconomic due to the transition to a competitive electric services industry. The economic consequences that would be incurred by a utility that is unable to secure the recovery of its stranded costs are extremely dire. The prospect of insuring utility recovery of stranded costs, however, may cause parties to impose or to agree to settlement terms or conditions that create additional competitive transition costs, either through the direct allocation of a charge or through the indirect creation of market barriers, that may appear to address public policy goals but do not do so in a manner that produces economically-justifiable results.

CEED asserts that the Settlement offered to the Department in this proceeding contains provisions that would create additional transition costs and establish market barriers, and should be subject to adjudication to ensure that these costs and market barriers will create demonstrated and cost-effective benefits for the citizens of the Commonwealth of Massachusetts and the businesses that operate here. These provisions include:

(1) a proposal to reform the Commonwealth's existing Energy Facilities Siting Board requirements so as to revise existing need and least-cost requirements without addressing existing preferences for so-called clean energy technologies;¹

¹See, Settlement, page 22 (41), § III.A.

(2) the imposition of unprecedented emissions reductions requirements at MECo generating units that significantly exceed the requirements of current law or regulation;² and

(3) the imposition of fees and generation resource portfolio goals upon Commonwealth electric retail customers that would, in part, subsidize the development of renewables technologies and conceivably set aside access to a portion of the Commonwealth's retail market for the purchase of renewable resources only.³

CEED understands that settlements, by their nature, involve the balancing of the diverse interests of many parties in order to secure those terms that are most important to the parties effected by the agreement. However, CEED must strongly urge the Department to proceed cautiously with its review of this Settlement and to ensure that parties that are not signatories to this Settlement are provided with the opportunity to challenge the provisions of the Settlement before the Department and to provide evidence in an adjudicatory setting.

DISCUSSION

After a cursory review of the Settlement, CEED offers the following initial comments to the Department for consideration:

1. Any revisions to the existing Energy Facility Siting statutes should not be biased against, or in favor of, any particular generation technology or service provider.

The proposal incorporated in the Settlement offer to reform the Commonwealth's

²See, Settlement, page 23 (42), § III.B.

³ See, Settlement, page 23-26 (42-45), § III.C.

siting requirements, presumably to accommodate a competitive wholesale and retail electric industry, create a bias against the siting of fossil fuel generation in Massachusetts in that the parties to the Settlement are attempting to preserve preferences for so-called clean energy technologies. CEED does not argue that the existing regulations need to be revised to reflect the changing market structure and would endorse the concept incorporated in the provision that would call for all interested persons to work cooperatively to update the existing statute. CEED also agrees, as the provision implies, that the market will determine the need for new power generating resources and will insure that those resources are procured at the lowest possible cost.

CEED fails, however, to see the need for maintaining requirements that would favor one type of generation technology or supplier over another in any way. In fact, it would be difficult to imagine how this would even be done in a competitive marketplace where the market is establishing the need and price for resources based upon the particular characteristics of each resource.

Nevertheless, the need for a public forum to comprehensively evaluate the local impact of siting power generation facilities would remain. Some governmental entity should continue to provide a centralized and organized forum for evaluating and expediting the completion and review of a comprehensive environmental impact statement. Such an entity may also be required to impose license conditions upon facility owners that would not be valued by the market, such as a requirement that an owner dismantle and remove project equipment from a site when it is no longer operating.

2. Emissions reduction requirements, as proposed in the Settlement, would impose significant additional costs on MECo generating units without producing relevant environmental benefits or promoting efficient environmental solutions.

The primary objective of the Department is to ensure that Massachusetts' citizens and businesses have access to reliable supplies of power at the lowest reasonable cost. Although the Department wishes to adopt policies that promote environmental objectives, these objectives should not be pursued at the cost of economic efficiency. More importantly, industry restructuring should not be seen as an opportunity to force stricter environmental emissions limitations on the power generating sector than are required under existing law and regulation. Environmental regulations have been designed to achieve environmental goals in a cost-effective manner by regulating not only the power sector but other stationary and mobile emissions sources. Compliance plans require significant environmental expertise to develop and regulatory authority to enforce, neither of which is possessed by the DPU.

The proposed Settlement would set more stringent environmental limitations on MECo's Massachusetts-based, fossil fuel generating resources for the emission of sulfur dioxide ("SO₂") and nitrogen oxides ("NO_x"), than any current or anticipated requirement that would be imposed by the Commonwealth or the federal government. The proposed SO₂ cap is calculated in the Settlement assuming a rate of 0.3 pounds of SO₂ per million British thermal units ("MMBtu") at historical capacity utilization levels. This amounts to a level that is roughly 75 percent below the unit's federal acid rain allocations under the Clean Air Act Amendments of 1990 ("CAAA"). This emission reduction requirement could only be achieved by a coal-fired unit, such as MECo's Salem Harbor and Brayton Point units, (1) by retrofitting the plant with expensive scrubber technology, (2) through the accelerated consumption of banked SO₂ allowances, or (3) through the retirement or repowering of the facility.

The emissions reduction limits imposed by this Settlement would increase ratepayer costs by increasing power production costs and the costs associated with

replacing these generating resources with other resources. At the same time, the imposition of this additional environmental control requirement will likely lower the market value of MECo's current generating assets, thereby increasing MECo's calculated "stranded cost."

The costs incurred due to this emissions reduction requirement must be considered within the context of the benefits that would be produced. Massachusetts is already in compliance with the national ambient air quality standards for SO₂. Since the ambient air quality standards are set to protect the public health, inclusive of a reserve margin for safety, it can be argued that no significant public health benefit will be incurred by those that will ultimately be responsible for the cost of this provision -- the electric consumers -- as a result of the imposition of this provision.

The same argument can be made for the emissions reduction requirements imposed by the Settlement on NO_x. In fact, this requirement only has a significant impact on the operation of the Salem Harbor unit due to its vintage. The provision would have the effect of imposing emissions reduction levels upon Salem Harbor three years earlier than they would have otherwise been required by the Department of Environmental Protection ("DEP") under another agreement. Although, the proposed NO_x reduction requirements could lower the calculated NO_x reductions needed from other sources to achieve national ambient air quality standards for ozone, these reductions may not benefit Massachusetts air quality given Salem Harbor's location in the northeast corner of the state. Any benefits created would be downwind of the plant over the Atlantic Ocean or, perhaps, along the Maine coast.

As Massachusetts moves to a market-driven environment, the reverse incentives of cost-of-service regulation relative to air emissions will be removed. Under existing regulation, the cost of extending the life of these facilities has been passed through to

ratepayers. A competitive market structure will force generation suppliers to competitively price their products and services. As a result, the costs, inefficiencies, and risks associated with older units may require these units to be retired, as will the tightening of national and regional environmental standards that will be imposed upon the marketplace by environmental regulators. All of these factors are likely to produce a more economically-efficient result and eliminate the need to skew the market against MECo's existing generation portfolio.

3. Subsidies or market set-asides for renewable technologies would impose significant additional costs on Commonwealth electric customers and create market barriers without any evidence that customers will receive any relevant environmental benefits.

By providing subsidies to support non-economic policy goals, Massachusetts electric customers will not be able to take full advantage of the potential power savings that will be available from deregulation. They will also be denied access to the lowest cost, most competitive power sources -- all of which must operate in compliance with all state and federal environmental regulations that are established for that resource. Before the Department approves any subsidy or market set-aside goals that would deny retail customers access to lower cost alternatives, it should be satisfied that the imposition of these types of market barriers will provide customers with economically-efficient results that justify such an approach.

According to the Settlement, the MECo budget for demand-side management and "clean" renewables programs for the period of 1998 through 2001 would be \$66.7 million, or \$71.40 per customer. There is also a goal that at least 4 percent of Massachusetts' power sales be supplied by "clean" renewable technologies by the year 2007. Assuming that average renewable production costs continue to be approximately \$0.075/kWh more expensive than conventional generation and that Massachusetts

customers purchased 4 percent of their electricity from renewables in 2007 (assuming load growth at 2 percent per year from 1994 levels), a subsidy of approximately \$150-180 million per year would be required to achieve the renewable goal agreed to in the Settlement because of the higher production costs. This is equivalent to approximately \$55-70 per customer per year (in 1996 dollars) across the entire state.

Therefore, the current renewable subsidy contained in the Settlement would be insufficient to achieve the 4 percent target at current projected generation cost levels. This raises a number of interesting questions. Would subsidies be used for more than research and development purposes to support purchases of uneconomic power in order to meet the renewable portfolio goal? If so, would subsidies be increased to achieve this goal or should the goal be lowered to meet funding levels? Further, if a percentage of market were to be set aside and limited only to a small group of competitive alternatives, might the price of power in this market be even higher given that competition is less robust? If other states adopt portfolio requirements, would this lead to a shortage in renewable capacity or capacity credits, further driving up the premium being paid by consumers due to the barriers imposed against other generation competitors?

CEED is also disturbed by the definition of “clean” renewable resources utilized in the Settlement produced by biomass generators emissions can be higher than conventional generation alternatives. Further these resources are often significantly less efficient because of the high moisture and ash content of biomass fuels. Just because it utilizes a waste resource, it is not necessarily a cleaner resource.

Wind, fuel cell, tidal and solar energy technologies also can have significant environmental impacts that need to be considered in evaluating the overall environmental and economic impact of each generation alternative. Like nuclear

power, the non-air quality impacts of these technologies can make renewable alternatives as undesirable as a conventional alternative at the local level. They can also make the siting of these technologies just as controversial.

No fossil fuel generator will be permitted to operate unless it meets all relevant environmental requirements. Under the CAAA, major stationary source limits are set so that emissions produced by a particular facility will not adversely effect the public health. In fact, in many cases, new generators will be required to remove more of a particular type of emission from the air than it will contribute to the air through the purchase of offsets in excess of 100 percent of the plants permitted emission level for that emission type.

CEED contends that the subsidies and portfolio standards established in the Settlement are not economically or environmentally justified in light of their cost and in light of the significant strides that are being made in improving the emissions performance of new technologies at a more competitive price. Further, the move from economic regulation to markets, together with the imposition of tougher environmental regulations nationwide under the CAAA and the resulting improvements in new fossil fueled technologies, will result in market-driven environmental improvements without requiring any additional subsidies from electric power consumers.

CONCLUSION

CEED asserts that the Settlement offered to the Department in this proceeding contains provisions that would create additional transition costs and establish market barriers, and should be subject to adjudication to ensure that these costs and market barriers will create demonstrated and cost-effective benefits for the citizens of the

Commonwealth of Massachusetts and the businesses that operate here.

CEED strongly urges the Department to proceed cautiously with its review of this Settlement and to ensure that parties that are not signatories to this Settlement are provided with the opportunity to challenge the provisions of the Settlement before the Department and to provide evidence in an adjudicatory setting.

CEED is grateful to the Department for providing this opportunity to submit initial comments in this proceeding and looks forward to participating actively in the adjudication of this case.

Date: October 29, 1996